Back to Basics: Using Time Horizons to Your Investment Advantage

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we are going to do a back to the basics. This is part of our ongoing Thursday episodes that we have a list of comments and questions and topics that we want to talk about that can kind of help beginner investors start the path to investing for themselves. So today's topic is going to be on the idea of a time horizon and how that that can be an advantage for individual investors. So I'm going to turn it over to my friend Andrew, and then we're going to go ahead and get started. So, sir Andrew, what are your thoughts on Time Horizon and how that can help beginning investors or just investors in general?

Andrew [00:00:40]:

Yeah, I think especially for beginners, it's one of those things that you don't even realize that you have. And I think I know for myself and maybe a lot of people who come into this, they actually think it's the other way where they have a disadvantage because they're not professionals. And we even, I think, answer the question about this recently. It's like, oh, well, how can I compete in the investment world against all these professionals who have all these resources and teams and technology and all of this? And really when we're talking about your investing in your retirement and building wealth for yourself, you do have a crazy advantage in that your time horizon can be whatever fits best for you. Thats structurally different than the time horizon. Thats in the finance industry. And if you can use it to your advantage, such as investing in the stock market for a very long time, you can outperform some professionals. Just to be frank.

Andrew [00:01:37]:

You can have wonderful results, but you have to recognize that you have that advantage and take comfort in that advantage and then use the advantage. And so thats how I think about Time horizon. How about you?

Dave [00:01:50]:

Yeah, I think about it very, very similarly, probably the same. And I think that our one, I guess, biggest structural advantage is because we don't have to play the same game that the people in the finance industry do, that we have different goals and incentives and objectives that structurally gives us the advantage of being able to buy a company and hold it for a longer period of time, to give it its legs, if you will, time for its legs to get settled and to get going. And sometimes that can mean that you can buy. There's different ways to make money in stock market, and the way that Andrew like and I like to do it may not work for some people, and other people may like another way and whatnot. So when you think about, like, growth investing, for example, sometimes when you buy an earlier stage company, you kind of have to wait for the thesis to play out. Some will go to the moon right away, and some may be more of a slow burn, if you will. And so sometimes you have to kind of wait for that thesis to play out. But as an individual investor, we have the opportunity or the ability to go, okay, I can do this, I can buy this company and forget I own it for the next seven years.

Dave [00:03:00]:

And that's really all you need to do sometimes. And you can take advantage of that. We also have the ability to dollar cost average, and we can use compounding as our friend, because the longer you hold these companies and the bigger they get, the better they're going to do for returns and whatnot. And also flip side of that is the longer you hold the company, the more your knowledge of that business compounds. So if you read, let's take Berkshire Hathaway, for example. If you read their annual report and their quarterly reports, the ten qs, if you read those, there's five reports you have to read about that company every year. If you do that for five years, I guarantee you're going to know a lot about that company just because of the sheer repetition of putting that information through your process and your brain. And so those kinds of things allow us, give us an advantage over the people in the finance industry because, yes, there's lots of smart people in there.

Dave [00:03:58]:

Lots and lots, lots of smart people in there, but they have different targets and different incentives and they're motivated by different things. And so they don't always have the same advantage or the same timeframe. They may be moving in and out of companies a lot. And so they can't build up that compounded knowledge of Google, for example, just because, or anything else meta, whatever, pick visa, pick a name. And so that can structurally give us an advantage over them because we can compound our knowledge, we can compound the money, and we can just sit and wait. And that's a lot of times that's the most effective strategy in investing is to buy something. You know, was Terry Smith say buy right, sit tight, don't do

anything. And I think he has a little more eloquent way of saying it, but I think that's a great way to think about investing, and that's a big advantage that we have over other institutional investors.

Andrew [00:04:55]:

Robert, buy right and sit tight. That's awesome. Yeah, that's got to be like right up there next to my live laugh love thing. That's cool. So, you know, you mentioned how, you know, parts of the finance industry are playing a different game. So maybe we can dig into some of that so people don't have to just take our advice for it. What's a good example of, you know, difference in incentives or difference in time horizon that is pretty common in the finance industry?

Dave [00:05:28]:

Well, I think the. Probably the most obvious one to me is the benchmarking and the fact that they have to stay on top of that benchmark to stay relevant and to stay profitable. So most investment firms, they'll make money on the investments that they make, but they also make money on the fees that they generate. And the best way that they can generate fees is to have assets under management. In other words, people investing with them. And in the market, everybody's always looking to try to beat the market. And so let's say that everybody wants to get an 11% return, not a 10% return. And so that's what they're judged on.

Dave [00:06:06]:

And these funds are judged on that. And there's. There's this thing called inflows and outflows, which basically means putting money in and people taking money out. And if a fund underperforms compared to their stated benchmark, you know, I think most people probably give them some grace period, but if it goes longer than a year, then they start losing. People start taking their money and going, putting it somewhere else, because there's this idea of opportunity cost, and why would I stay with this person who's underperforming when I can go over here and this person is outperforming? And so that's why you see a lot of these fund managers up and down like a roller coaster and see that their returns are all over the place. And you see that their assets under management are all over the place. Or you see, during the pandemic, Kathie Wood was in her Ark investment fund was all the rage, and everybody loved it. You know, everybody was piling into her fund, and she's underperformed the market since then.

Dave [00:07:01]:

And so you've seen a lot of money being taken out of her fund, and her relevance has dwindled to almost nothing. And that's kind of the prime example of what I'm talking about, is there investors will only measure these people based on their returns that they get that particular year. So that puts a lot of short term focus

blinders on, because their incentives are to get more people to invest with them and they got to perform. So if they don't, they're done.

Andrew [00:07:31]:

Yeah. And just to kind of talk about the plumbing behind that, the inflows and outflows. Thats real cash that these managers have to manage. So a fund thats having tons of outflows has to sell out of its biggest positions. And when the markets down, thats the time you want to be adding and doubling down and backing up the truck. But theyre literally structurally forced to do the opposite because of the inflow and outflow situation. And so as an individual investor, you don't have to do that at all. You can see the market down 50% and look at it as a buying opportunity.

Andrew [00:08:12]:

And maybe you, I don't know, I'm not advocating, like, emptying your emergency fund or anything, but, you know, maybe you shift a priority between your next frivolous purchase and you're like, I want to buy more stocks. This is a great opportunity. That's something that a fund manager just simply can't do. They can't just manufacture inflows out of thin air. And like you were saying, it really can magnify some of the, both the ups and the downs that some of these funds, mutual funds, ETF's all have to go through.

Dave [00:08:42]:

Right, right, exactly. And I think we should clarify. When we're talking about funds, we're not talking about something like an index fund. What we're really talking about are actively managed funds. So people that are actively buying and selling individual companies, the ones that are being done via computer or robo advisors and those kinds of things, that's not what we're talking about, because those are automated. And what we're really talking about is more people buying, like we're doing buying and selling individual companies, but on a large, far bigger scale. And when people think about the returns that they have to generate, that's what makes their game, I think, really stressful and really hard, because to me, when you have a company like Nvidia that kind of comes out of nowhere and is generating, you know, 100% returns over a year or two, if you don't own it, you're trailing. Yeah, I mean, you could have the rest of the s and P 500, and you're still not going to beat Nvidia's returns.

Dave [00:09:43]:

And so becomes a game of. And it also helps explain why some of these companies go parabolic like that, because the market sees that Nvidia is catching a hot streak, and so everybody piles into it because they have to, they're incentivized to stay with Nvidia or outperform it. And a lot of times, if you look at the individual holdings of a lot of actively managed funds, they all own the same things. There isn't a lot of

difference because you have to own the mag seven, you have to own Google, Amazon, Microsoft, meta, Nvidia. If you don't, you're going to struggle. And that really comes down to more of the short term focus. I'm not saying the five to ten year focus you can outperform by having a longer time horizon than you, because now you're forced to play the same game that these people are all playing. And that's when it becomes much harder for us to try to compete because, yeah, they got a lot more resources, you know, brilliant people running these games, inside information that we aren't privy to.

Dave [00:10:45]:

I'm not saying insider trading, but they just have more, you know, connections to companies, so they have better insights into what's really driving Nvidia then you and I can just by reading the statements, so all those things can lead to this game of hopping in and out of companies just to make sure that they stay at that, you know, 27% return that the Nasdaq got last year. I mean, those are crazy numbers to try to compete with. And that just gives me heartburn just thinking about it.

Andrew [00:11:17]:

I mean, something that really kind of helped illustrate this for me is it's a career, right? And for some people, you know, maybe they do it because they're passionate and maybe they beat a different drum, but maybe a lot of people, it's just a career. And so, you know, it's, it's tough to blame a new fund manager for not wanting to step out on the wrong foot or getting left behind and all the feelings and emotions that can come with that. And unfortunately, the history of the stock market has shown that if you want success over the long term time horizon, you have to do the opposite. And so it is challenging for different managers in different stages of their career doing things that may cripple the long term performance, but helps them maintain, you know, whether it's job security or being able to fit in the other fund managers, whatever it is. Right, right. Lots of different factors.

Dave [00:12:10]:

Yeah, lots of different factors. You know, the more that I think about these kinds of careers, it gives me more respect for people like Bill Ackman and Monish Purbrai and Guy Spear and Chuck Acree. And, you know, the list can go on and on and on because they have chosen to do play the game a little differently and try not to, you know, they try to have more of a, I guess, a value investor mindset where they try to invest for a longer term and don't get caught up in the, the rat race or the wheel of trying to compete with all the other people. And I think that contrarianism makes it attractive to me to think about what these people go through and how much harder it is to work at Goldman Sachs or something like that and have to meet these. I got to outdo Nvidia this year. What's going to be the next Nvidia? To me, that's just like I said, it gives me heartburn thinking about it.

Andrew [00:13:12]:

So there's the long term, right. And then I think there's also market timing. Can we speak to that and why investors, average investors, can choose to not play that game.

Dave [00:13:24]:

Yeah. So kind of go back to the rat race of having to keep up with the Joneses, if you will, is they have to, in essence, market time and they have to spend a lot more time trying to market time. When is Nvidia going to hit and when is it going to stop? When is the meta going to hit? When is it going to stop? So every investment you have to make, it's not necessarily on, this is the best value for the company right now. It's more about what can I earn off of this over the next year, 16 months, 18 months, whatever, or seven months? What can I earn from this and how can that help me make sure that I maintain my beating myself stated goal and keep my assets under management to keep the money flowing in? And that's a different game than what Chuck Ackery is doing when he buys Crown Castle in 1994 or whatever it is, and he still owns it today. The completely different game. And individual investors, we have the same ability to do what Chuck Ackery was doing. We don't have to worry about buying Nvidia at the right time. We can buy Nvidia because we think it's going to be a great value from now until the next 20 years.

Dave [00:14:38]:

And I think that gives us an advantage over those people because again, they have to play a different game. They're having to go in and out of the markets a lot more and you have to pay a lot more attention where when you're buying Mastercard, it's a lot easier to go sit on the beach and drink pina colada than it is trying to worry about whether Nvidia is going to beat or not beat this month.

Andrew [00:14:58]:

Yeah, theres a lot of resources spent on trying to get the earnings estimates and the specific valuations at every second of every day. Super precise. And I would wonder if the amount of resources that are used on that is not equal to the amount of trying to do it from a ten year time horizon or 20 year time horizon. There's a lot of that short term like, all right, the company did this this month, they're guiding for this next month. And so we're adjusting our price target by this much. And that's a lot of work and it's a lot of energy and a lot of resources that can go into that. And today's point, we don't have to play that game. If you're holding for 10, 15, 20 years, the difference between a percent here or percent there when you buy is less impact to your total portfolio return than if you made the decision to buy.

Andrew [00:16:00]:

Right and sit tight.

Dave [00:16:01]:

Yep, exactly. I think to that end, think about the people that are investing in these kinds of funds, too, because you have to pay. If your goal is to outperform the market, then you have to spend a lot more time paying attention to how those funds are doing. So if you put a lot of money into one fund, that could be the hot one of the moment. And two years from now it's not, then you got to go through the process of taking the money out, going to find another one, putting the money in there. Those things, a, don't happen overnight and b, are not easy to do. It's not just like going to your local bank and taking all your money out of your account and closing the account. It's not quite that simple.

Dave [00:16:43]:

So there's a lot more effort and work involved to do that. And to Andrews Point, as individual investors, we dont have to do that. We can choose what we want to buy and sell, when we want to buy and sell and go from there. And it just makes your life a lot simpler. We a lot of times think that to invest in the stock market has got to be super complicated and a 24/7 kind of job, and it doesnt have to be that way. I think when you kind of take that mindset of, okay, this is, I don't have to quit my day job to do this, I can do this, you know, on the side and be successful at it by just taking my time and having patience, then I think those things, I think go a long ways towards having a better life. You know, yes, you may make more money doing the rat race and whatnot, but what is that worth to you in your personal life as you kind of step back 1520 years down the road? Would you have rather spent more time with your daughter or your son or your wife? Or would you have rather spent more time reading a ten k and stressing about whether this fund or that fund is going to outperform? And I know the answer for me, but everybody's built different, but that's the way I would want to look at it.

Andrew [00:17:59]:

So do you think your chosen stock picking strategy and your ideal investment result have correlation in that way, where the stock strategy is a good model, good fit for what your desired outcome is?

Dave [00:18:16]:

Yes, I feel like it fits what I want my life to be. I mean, you and I spend a lot of time in the market because we like it and it's a passion of ours and whatnot. But it also gives us the benefit to get what we want down the

road and our objectives, and it also gives us the ability to have a lifestyle that we want. And so to me, they correlate. The strategy that I've utilized also correlates with what I want for my life or for the rest of my life.

Andrew [00:18:44]:

Yeah. And so I think that kind of speaks to the different game and the different time horizon when all the time you're not spending trying to figure out if Nvidia is going to continue to be hot or not is time you can spend building those like longer lasting investment return positions. And then the more of those you have now, the more time you have to find the next long term compounding investment choice. And so I think by making the choice of saying im going to invest in companies that can compound without any effort on my part, you open up the potential to continue to find those. And I think its a really sweet spot in investing in the stock market and finance.

Dave [00:19:30]:

Yep, I agree. There's probably one other advantage that we have as individual investors that maybe the larger funds don't have that we haven't spoken about yet. And to me that is the idea that we can buy pretty much anything we want. And size is not a determinant of whether we buy or not a company. You want to maybe speak to that a little bit?

Andrew [00:19:53]:

Yeah. You know, there's hidden gems all throughout the stock market and companies that could be as small as 200 million or 500 million in market cap. And so if I'm a fund manager who is trying to allocate, let's say I have 5 billion in inflows this month and I want to try to allocate it and put it to work. I'm not even going to spend the time on the $200 million market cap company because that's a fraction of what I'm trying to invest in, and im going to end up buying the whole company outright if I buy the $200 million. So kind of like, the bigger you go, the less there is, but then the smaller you go, the more opportunity that some of that stuff can show itself. And its because of just the sheer numbers and the size. And so we can fish in different ponds than an institutional investor trying to allocate 5 billion or 10 billion or whatever it is.

Dave [00:20:51]:

Right. Yeah. It just makes it easier for us to have that many more choices to choose from. The best returning stock over the last five or ten years is monster beverage, which started off as a microcap. So very, very, very small company. And as individual investors, we could all partake in that. The funds, they wouldn't be able to touch it, and so they would have missed out on that 200 bagger, whatever it's been, because they just wouldn't been able to invest in that company because it was so small. And so that gives us another advantage over them that we can basically, it just opens up our universe of potential targets to invest in.

Dave [00:21:32]:

And you don't have to just stick with the big market, large market caps, if you don't want to. You can make a lot of money in those, too. But I just think it just, it gives you a lot more playing room on the field to go and try to find things that the big boys aren't playing in. And that also gives you a little more opportunity to take advantage of these great companies, because there's lots of them that we just don't think about, that they do very foundational, necessary things that kind of happen in the background, but can be great investments. Again, it doesn't have to be the shiny stuff. That's the thing that can be the best investment. Sometimes it's the simple, boring ones that are the best.

Andrew [00:22:12]:

I wonder if we could see more of that, too. I mean, who knows what the future holds? But it would be cool to see a return of companies ipoing at a smaller size if that were the case, because the last 20 years have been very strange in, you know, companies staying private and IPO land and all that.

Dave [00:22:31]:

Right.

Andrew [00:22:31]:

We could see more of those opportunities 510, 20 years down the road, which would only increase the advantage for the average Joe.

Dave [00:22:41]:

Right.

Andrew [00:22:41]:

And that could be kind of fun.

Dave [00:22:43]:

It could be a lot of fun. And I was lucky enough to talk to Ian Castle, who's kind of the king of microcaps, a little while ago. And one of the things that he said to me that really struck me is, you dont have to change your investing style to invest in smaller companies. And that was one of the, I guess the misconceptions that I had was that to go down that path of looking at smaller companies, that I had to change the way I invest.

And you dont. If you still are more of a buffet munger kind of investor, you can do that in those micro caps just as well as you can in the large caps. So it really gives you, again, more choices on the playing field. And I'm all about that.

Dave [00:23:23]:

You know, if you have the opportunity to find other things, then I think that just gives you more opportunity to find the things that are going to work best for you.

Andrew [00:23:31]:

Yep. Yeah. That's awesome.

Dave [00:23:32]:

All right, well, with that, we will go ahead and wrap up our show for today. I hope you enjoyed our back to the basics again. Come back every Thursday. That's when we will have another episode of back to the basics until we work through our catalog. So with that, we will go ahead and sign us off. You guys go out there and invest with a margin of safety. Emphasis on the safety. Have a great week, and we'll talk to you all next week.

Dave [00:23:54]:

Bye.

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